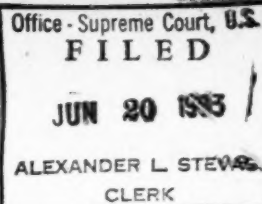


82-2081



No. _____

IN THE SUPREME COURT
OF THE UNITED STATES

October Term, 1982

OCEAN SANDS HOLDING CORPORATION,
a Virginia Corporation, et al.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
FROM THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

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The other petitioners are as follows in these consolidated cases:

(1) Sea Fin Holding Corporation v. Commissioner, (2) Chattel Corporation v. Commissioner, (3) Sea Star Corporation v. Commissioner, (4) Colony Holding Corporation v. Commissioner, (5) Russell W. Chaplain, Jr. and Mary H. Chaplain v. Commissioner, (6) William G. Chaplain and Sandra B. Chaplain v. Commissioner, (7) Russell W. Chaplain, Sr. and Elsie B. Chaplain v. Commissioner, (8) William J. Newton, III and Linda G. Thornton, nee Linda G. Chaplain, formerly Linda G. Newton v. Commissioner.

QUESTIONS PRESENTED

I

Did the Commissioner of Internal Revenue violate the Seventh Amendment rights of the petitioners in assessing duplicate and unjustifiably prohibitive notices of deficiency against them which precluded the payment of taxes and suit for refund, with trial by jury, in the United States District Court.

II

Should the separate tax cases of the petitioners been consolidated and tried by the United States Tax Court over their objections.

III

Did the United States Tax Court err in finding that the gross receipts of the corporate taxpayers were understated.

IV

Did the United States Tax Court err in finding that the deductions for depreciation and expenses of the corporate taxpayers were overstated.

V

Did the United States Tax Court err in finding that the statute of limitations did not bar assessment and collection of alleged deficiencies for Ocean Sands Holding Corporation for 1967.

VI

Did the United States Tax Court err in assessing fraud penalties against two of the corporate petitioners when it held the individual taxpayers did not commit fraud based upon identical conduct and evidence.

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OPINIONS BELOW

The Memorandum Findings of Fact and Opinion of the United States Tax Court, Tax Court Memorandum 1980-423 is printed in Appendix A hereto, infra , page A-1.

The unpublished opinion of the United States Court of Appeals for the Fourth Circuit concerning the consolidated cases of Ocean Sands Holding Corporation, et al is printed in Appendix A hereto, infra , page A-197.

JURISDICTION

The judgment of the United States Court of Appeals for the Fourth Circuit (Appendix A, infra , page A-1) was entered on February 11, 1983. The jurisdiction of the Court is invoked under 26 U.S.C. Section 7482(a) and 28 U.S.C. Section 1254(1).

CONSTITUTIONAL PROVISIONS
AND STATUTES INVOLVED

U.S. CONST. AMEND. VII

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

26 U.S.C. Section 6501(e)(1)(A)

General rule. If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax

may be begun without assessment, at any time within 6 years after the return was filed.

26 U.S.C. Section 7454(a)

Fraud. In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary.

STATEMENT OF THE CASE

These cases originated in 1967 when, after reading newspaper accounts concerning various individual members of the Chaplain family being embroiled in non-tax controversies with local authorities, Internal Revenue Service agents , who had been assigned cases on individual taxpayers Russell Wilson Chaplain, Sr. and his wife, Elsie B. Chaplain, began investigations of corporations owned by members of the Chaplain family. the matters were referred to the Criminal Investigation Division of the Internal Revenue Service for investigation of criminal fraud and investigations of both individual and corporate taxpayers were begun.

As stated by the Tax Court "some understanding of the family history of

the Chaplains and their financial transactions is essential to a fair and proper evaluation of the merits of these cases"; that family history includes the following facts which are not in dispute.

Russell Wilson Chaplain, Sr. married his wife, Elsie B. Chaplain, in 1941 and together they raised eight children, several of which have become parties, as individual taxpayers to the consolidated cases.

In 1950 the senior Chaplain was found to have sugar diabetes and, because of this, and other health problems, he withdrew from active involvement in the family businesses. From 1950 on the senior Chaplain did not participate in the family businesses other than to occasionally consult with those members of the

family who were responsible for the operation of the various businesses on methods of building construction and design and discuss generally how the family interests might be advanced.

Russell Wilson Chaplain, Sr. never owned stock in any of the corporations, and was never a director, officer or employee of any of the corporations.

Although the Tax Court characterized Russell Wilson Chaplain, Sr. as "the patriarch and the brain of the Chaplain family" it was always Elsie B. Chaplain who directed the family in its various enterprises. Elsie B. Chaplain was the sole stockholder of any stock that had been issued by any of the corporations. At no point in time has Russell Wilson Chaplain, Sr. ever claimed ownership or involvement, legal or beneficial, in

the corporations operated by his wife and children.

Elsie B. Chaplain directed the operation of the corporations; the eldest son, Russell W. "Chappy" Chaplain, Jr., and his brother, William G. "Jerry" Chaplain, were in charge of construction and maintenance of the corporate properties and the eldest daughter, Suzanne Chaplain Goldsticker, was responsible for the maintenance of all corporate records and the majority of banking and bookkeeping for the corporations.

The Commissioner determined deficiencies in tax and additions to tax against the petitioners for years between 1967 through 1973.

Duplicate notices of deficiency, by the admissions of the Internal

Revenue Service, were assessed against both individual and corporate taxpayers in the cases. Due to the prohibitive amounts alleged in the notices of deficiency and the fact that these were duplicated, the petitioners were unable to pay the tax and then sue for a refund in the United States District Court.

Accordingly, the taxpayers filed petitions for redeterminations of the asserted taxes and additions to tax in the United States Tax Court.

Separate cases were instituted by these petitioners in the Tax Court. By order of the Tax Court, these cases were consolidated for trial, briefing and opinion over the objection of the petitioners. Among these cases was the case of Ocean Sands Holding Corporation v. Commissioner of Internal Revenue

(Record No. 81-1467) in which the Tax Court held that the 6 year statute of limitations as set forth in 26 U.S.C. Section 6501(e)(1) did not prohibit the Commissioner from attempting to collect an amount alleged in his notice of deficiency to be in excess of 25 percent of the gross income stated in the return of the petitioner even though the only evidence presented by the Commissioner was unsubstantiated , hearsay to which timely objection was made by the petitioner.

During the years in question there were five corporations owned and operated by Elsie B. Chaplain and her children:

1. Ocean Sands Holding Corporation.
2. Colony Holding Corporation.
3. Sea Fin Holding Corporation.
4. Chattel Corporation.
5. Sea Star Corporation.

Ocean Sands Holding Corporation owned and operated the Kona Kai motel, which consists of the land and improvements located at 18th Street between Atlantic Avenue and the oceanfront in Virginia Beach, Virginia.

Colony Holding Corporation owned and operated the Kona Kai East motel , which consists of the land and improvements located at 16th Street between Atlantic Avenue and the oceanfront in Virginia Beach, Virginia.

Sea Fin Holding Corporation owned and operated the Colony Motel and Trailer Park and a Phillips 66 service station, all of which consist of the land and improvements located in the 900 block of Virginia Beach Boulevard in Virginia Beach, Virginia.

Chattel Corporation and Sea Star Corporation each owned one unimproved lot between 18th and 19th Streets on the oceanfront in Virginia Beach, Virginia.

The investigations by the Commissioner as well as the proceedings before the Tax Court were saturated with hostility between the Commissioner and his agents and individual members of the Chaplain family; the Tax Court recognized that there existed "emotionalism and ... venom among the parties". The Tax Court determined that "Petitioners ... failed to preserve diligently those business records that were made" and assigned responsibility for this failure to statements made by the senior Chaplain. The interpretations of the Tax Court of the personalities and circumstances

revealed through the evidence became its findings of fact. These findings of fact were drawn from proceedings typically marred by confusion, invective, innuendo and in a pervasive atmosphere of hostility.

The Tax Court filed its Memorandum Findings of Fact and Opinion on September 23, 1980 , and entered its decisions on April 27, 1981. The Tax Court entered its decisions in favor of the Commissioner in three of the 22 consolidated proceedings, and in the 19 other cases, it determined amounts owing somewhere between the amounts asserted by the Commissioner and those claimed by the taxpayers.

The Tax Court determined that the conduct of the individual taxpayers did not constitute fraud but that the identical conduct of the same

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individuals, in their capacity as corporate officers, did constitute fraud on the part of the corporate taxpayers.

Taxpayers filed timely notices of appeal and the cases were consolidated for appeal in the United States Court of Appeals for the Fourth Circuit by its order dated July 16, 1981.

On February 11, 1983, in an unpublished opinion, the United States Court of Appeals for the Fourth Circuit affirmed the decision of the United States Tax Court.

The petitioners filed a timely Petition for Rehearing with the United States Court of Appeals for the Fourth Circuit, which petition was denied by that court on March 21, 1983.

REASONS FOR GRANTING THIS WRIT

I

The Commissioner initially filed grossly inflated notices of deficiency against these petitioners alleging huge deficiencies and additions to tax due because of alleged fraud. These figures were in excess of \$3,600,000.00.

The deliberate, gross overstatement of deficiencies and additions to the tax by the Commissioner economically prohibited the petitioners from paying the tax and then suing for a refund in the United States District Court and exercising their Constitutional right to a trial by jury.

The petitioners contend that the record clearly shows that the huge

notices of deficiency and additions to the tax were deliberately filed by the Commissioner and that, based upon the findings of the Tax Court these notices of deficiency and additions to the tax claimed by the Commissioner were, without exception, greatly in error.

The petitioners contend that they owe no tax; however had the Commissioner utilized an accurate and sensible method of estimation of income the petitioners would have been well able to pay the alleged tax and then sue for a refund before a jury.

The Tax Court recognized the hostility that existed between the Commissioner and the petitioners. The hostility was not one sided and the petitioners submit that, as a result of their hostile feelings towards the petitioners agents of the Commissioner

intentionally inflated all of the figures in the notices of deficiency and additions to the tax to such an incredible level for the purpose of ensuring that the petitioners could not pay the tax and thus sue for a refund before a jury in the United States District Court.

The petitioners submit that this constant course of conduct by agents of the Commissioner was in derogation of their civil rights and was intended to, and did, effectively prevent them from exercising their Constitutional rights under the Seventh Amendment to the United States Constitution.

II

The petitioners involved in these consolidated cases noted their separate, distinct and independent

appeals. Unfortunately, the findings of fact and determinations of the United States Tax Court, and thus the fates of the corporations, became inextricably enmeshed with the cases of the individuals, most notably that of Russell Wilson Chaplain, Sr..

The Tax Court's interest in the personality of Russell Wilson Chaplain, Sr. led it to anthropomorphize the petitioner corporations and attribute to them his motivations, passions, emotions and thought processes. This line of association eventually led the Tax Court to refer to the senior Chaplain as a corporate officer when there is no evidence upon which to base this deduction.

It is important to keep in mind the magnitude of the cases against petitioners. The Commissioner asserted

over \$3,600,000 in deficiencies and additons to tax which covered sixty separate matters to be considered by the Tax Court. There were thirteen separate individual and corporate petitioners.

Yet, at the hearing held January 17, 1979, the Tax Court ordered the cases of the individual and corporate petitioners consolidated for trial, briefing and opinion.

The petitioners desired, and were entitled to, separate consideration of each of their cases on the merits. There can be no question that a corporation is a separate legal entity. This was first established by the decision of this Court in the case of Dartmouth College v. Woodward , 4 Wheat (17 US) 518, 636 (1819). It is also equally clear that the corporate entity

"is not to be disregarded merely because the corporation is controlled by a single family" Mead Corporation v. Commissioner , 116 F2d 187 (3rd Cir. 1940); Jud Plumbing & Heating, Inc. v. Commissioner , 153 F2d 681 (5th Cir. 1946).

In denying the petitioners separate trials the Tax Court ruled to the prejudice of the petitioners.

III

The Tax Court determined that Ocean Sands Holding Corporation (Kona Kai), Colony Holding Corporation (Kona Kai East) and Sea Fin Holding Corporation (Colony Trailer Park and Motel) gross receipts were understated by petitioners for various tax years from 1967 to 1973.

These findings were reached after presentation at trial, by the Commissioner, of multiple, often conflicting, methods of reconstruction of the income of petitioners.

The Commissioner utilized three basic methods of reconstruction of income of the petitioners and altered his approach towards reconstruction in an effort to maximize the liability of the petitioners as opposed to trying to ascertain the actual liability, if any, actually existing. These methods were:

1. Direct Method: This method consisted of reconstruction of gross income based upon the records of petitioners, such as motel registration cards.

2. Linen Expense Method: This method was initially employed

by state tax investigators in investigating alleged sales tax deficiencies. The method consisted of estimating the occupancy of motels by interpolation of linen expense for that motel.

3. Income from Comparable Motels: This approach was "based upon the assumption that gross receipts per room per month must have been equal to the average receipts per room per month of a group of comparable motels in Virginia Beach."

A fourth, ancillary method employed by the Commissioner to increase his determination of petitioners' alleged income was the reconstruction of alleged income from

telephone charges. Evidence was introduced at trial which showed that during the years in question C&P Telephone Company charged five cents (\$.05) per message unit to petitioners for telephone service. IRS agents assumed, without substantiation, that appellants charged motel guests twenty-five cents (\$.25) per call and therefore charged petitioners with twenty-cents (\$.20) income for each telephone message unit. This unfounded assumption remained unproven at trial.

A fifth, ancillary method employed by the Commissioner in reconstructing income for Sea Fin Holding Corporation (Colony Trailer Park and Motel) consisted of a review of the records of Virginia Electric and Power Company (Vepco) which purported to accurately ascertain the number of paying tenants

staying at the park at any given time. The record continually reflects that the estimates of spaces available at the park during any given tax year were a source of continuing controversy.

Citing Holland v. United States , 348 US 121 (1954). The Tax Court held that where the taxpayer's records were inadequate or nonexistent, the Commissioner would be allowed to reconstruct income by the use of any method which would, in the opinion of the Commissioner, clearly reflect income.

The only restriction on this rule is that the method adopted must be reasonable. Stone v. Commissioner , 22 T.C. 893, 905 (1954).

After finding the Commissioner to have inflated his determinations by an

average of 50%, the Tax Court further reduced those determinations by arbitrary percentages to reflect the existence of special factors affecting the various petitioners. It would seem that if the methodology of the Commissioner was reasonable then it would have reached reasonable determination of reconstructed income and the equitable intervention of the Tax Court would not be have been necessary to protect the taxpayers.

The decision of the Tax Court reflects the following margins of error by the Commissioner.

1. Ocean Sands Holding Corporation
(1967, 1968 and 1969):

The Court determined that the Commissioner had inflated determinations approaching an average

margin of error of 50% for the years in question

Ocean Sands Holding Corporation
(1971, 1972 and 1973): The Tax Court determined that the Commissioner overstated his determinations of deficiency, on the average, by a margin of error of 50%.

3. Colony Holding Corporation
(1972 and 1973): based upon the same methods and evidence the Tax Court found that the Commissioner overstated his determinations of deficiency against this petitioner, on the average, by a margin of error of 72%.

4. Sea Fin Holding Corporation
(1971, 1972 and 1973):

The Tax Court found that the Commissioner overstated his determinations of deficiency against

this petitioner on the average, by a margin of error of 18%; this is contrasted with the average of 5.5% error of understatement attributed to the petitioner.

These petitioners were constantly required by the Tax Court to prove that they did not receive income as determined by the Commissioner. The case of Weir v. Commissioner of Internal Revenue , 283 F.2d 675 (6th Cir. 1960) states,

"The law imposes much less of a burden upon a taxpayer who is called upon to prove a negative - that he did not receive the income which the Commissioner claims ..."

The Sixth Circuit, in the above case, goes on to state,

"The Commissioner's determination is presumed correct, but if error is shown, the presumption disappears and the Commissioner then has the burden of proving the

correctness of his
determination, or at least
the correct amount actually
due."

In these cases the Commissioner made
conflicting determinations against
these petitioners. In Revell, Inc. v.
Riddell , 273 F.2d 649 (9th Cir. 1959)
the Court observes that,

"Conceivably the Commissioner
may lose the benefit of such
presumption if it should be
made to appear to the Tax
Court that the Commissioner
has made conflicting
determinations against the
same person in respect to the
same income. In such event
the burden of proof would be
upon the Commissioner to
establish the correctness of
his determination."

A deficiency determination which
is not supported by the proper
foundation of substantive evidence is
clearly arbitrary and erroneous.
Weimenskirch v. Commissioner , 596 F.2d
358 (9th Cir. 1979).

The core flaw running throughout all of these consolidated cases is the consistent arbitrary determination, by the Commissioner, of huge amounts of income deficiencies asserted against the petitioners, both individual and corporate. The Commissioner blatantly duplicated huge determinations of deficiency. Coupled with this is the consistent holding of the Tax Court that the Commissioner repeatedly overstated deficiencies by an average margin of error of 50%.

The Ninth Circuit states the law, and petitioners' argument, eloquently in the case of Cohen v. Commissioner of Internal Revenue , 266 F.2d 5 (9th Cir. 1959) in the following opinion,

"When the Commissioner's determination has been shown to be invalid, the Tax Court must redetermine the deficiency. The presumption as to the correctness of the

Commissioner's determination is then out of the case. The Commissioner and not the taxpayer then has the burden of proving whether any deficiency exists and, if so, the amount. It is not incumbent upon the taxpayer under these circumstances to prove that he owed no tax or the amount of the tax which he did owe.

The Commissioner's determination is invalid when it is arbitrary or erroneous. Whether or not the Commissioner's determination in this case was arbitrary, it was at least erroneous in substantial respects, Cohen accordingly met his burden of proof of proving that the Commissioner's determination was invalid.

The question is not whether the determination was invalid after the Tax Court had reduced it by 85%. The pertinent inquiry is whether it was invalid as originally computed by the Commissioner.

Cohen, having met his burden of proving the Commissioner's determination invalid, and thus taking the presumption of the correctness of that determination out of the case, was not chargeable with failure to make a further showing. Hence it was

improper for the Tax Court in making its redetermination to accept its maximum possible gross income figure as the actual figure only because Cohen failed to show a lesser amount."

In the cases before this Court the above opinion applies with equal force. The holdings of the Tax Court clearly show the Commissioner's initial determinations of deficiency against these petitioners to have been arbitrary, or at the very least, grossly erroneous. This being the case, the Tax Court should have held that the Commissioner had forfeited the presumption of correctness that normally attaches to his determinations and the Tax Court should have ensured that the burden of proof was shifted upon the Commissioner instead of allowing it to remain, wrongly, upon these petitioners to combat the

incredible allegations levied by the Commissioner.

IV

The Tax Court determined that depreciation and business expense deductions were overstated by the corporate petitioners in these consolidated cases.

Ocean Sands Holding Corporation's basis for depreciation of the Kona Kai was \$301,000. Colony Holding Corporation's basis for depreciation of the Kona Kai East was \$473,622. In the notices of deficiency the Commissioner adjusted the Kona Kai's basis to \$204,600 and did not allow the Kona Kai East any depreciation expense.

The Commissioner also disallowed numerous expense deductions in addition to depreciation for Ocean Sands Holding

Corporation, for Colony Holding Corporation and for Sea Fin Holding Corporation.

Although the Commissioner touted the validity of the comparable method for reconstruction of the income of petitioners, he refused to even consider comparable expenses of the other motels.

In looking at these obvious inconsistencies it is apparent that the Court erred in allowing the Commissioner to retain the presumption of correctness while it invoked Halle v. Commissioner 7 T.C. 245 (1946) to claim that the evidence of the petitioner's amounted to mere reaffirmance of return data which was unworthy of consideration.

When faced with these cases the taxpayers were faced with substantial difficulty in reconstructing events due to the length of time that had passed and the sheer volume of research necessary.

The one person who could adequately bring all of this information together was Russell W. "Chappy" Chaplain, Jr. and he did so by painstakingly itemizing and reconstructing the costs of the motels.

The Tax Court recognized that the cost basis for the Kona Kai and the Kona Kai East was considerably less than the appraised value of the structures when they were completed. The Court correctly indicated that the tax basis for depreciation was the actual cost of the buildings. Again, the only person with any knowledge of

the cost basis was "Chappy" and yet the Court largely ignored his evidence.

In Potts, Davis & Company v. Commissioner , 431 F.2d 1222 (1970) the Court stated "the Tax Court is not ... free to ignore the uncontroverted testimony of the taxpayer". It is clearly error for the court to have ignored the testimony of the witness most knowledgeable in these matters on the basis that he was a party to the proceedings.

An arbitrary assessment by the Commissioner may destroy the presumption that his determination of deficiency is correct. Mills v. Commissioner , 399 F.2d 744 (4th Cir. 1968).

It logically follows that, with the articulated cognizance of the Court

of the distrust, hate and disharmony between the parties, to allow the Commissioner to retain his presumption of correctness in the disallowance of petitioner's proper depreciation and business expense deductions after such obviously arbitrary exercise of this presumption that the Court clearly erred.

V

The Tax Court, basing its opinion on Section 6501(E) of the Internal Revenue Code determined that the Commissioner was not barred by the Statute of Limitations in assessing tax for the year 1967 against Ocean Sands Holding Corporation.

The deficiency notice for 1967 was dated March 10, 1972. Where the Commissioner relies upon the above

cited section in the assessment or collection of tax he has the burden of proving facts and circumstances entitling him to the application of the section. Sammons v. United States , 433 F.2d 728 (5th Cir. 1970).

The Tax Court determined that the Commissioner had met his burden based on the Court's findings that the corporation had gross income of \$62,010 in 1967 and had reported gross income of \$29,106.51 on its 1967 corporate return.

The gross receipts in the subject year, as found by the Tax Court, were based upon Ocean Sands reconstructed income as determined from the use of spread sheets showing alleged laundry expenses and telephone charges.

The Tax Court also held that during at least a portion of 1967, construction on all the motel rooms was not completed; the elevator was not completed and that for varying periods between 1967 and 1973 as many as four rooms were used by Suzanne Chaplain Goldsticker as a manager's apartment. It was uncontradicted that, during 1967, there were only 24 rooms available for rent in the motel operated by the corporation.

The laundry expenses were based solely upon work papers prepared by Virginia State Tax authorities.

During the course of trial, a subpoena duces tecum was served on National Linen Service demanding the production at trial of records pertaining to Ocean Sands Holding Corporation to include invoices,

delivery tickets, books of entry and journal ledger entries through which the Commissioner intended to attempt to justify the figures contained in the spread sheets prepared by the state tax investigator, subsequently obtained by the Commissioner and upon which the Commissioner relied for his proof in establishing deficiencies against the petitioner for the year 1967.

However, at the time of trial, the records were not available, having been routinely destroyed by National Linen Service pursuant to their usual administrative procedure in purging old records. The only documentary evidence available through the linen service was the National Linen Service Price List in effect in 1967 . The delivery invoices and other records had only been maintained for a period of three

years and then were destroyed as outlined above.

Statutes of limitation are enacted for the very purpose of preventing what happened in this case. The Commissioner has utilized a state revenue agent's schedule based upon records which no longer exist because of the passing of time.

Despite the continuing objection of the petitioners, the Tax Court admitted this hearsay and the Commissioner accordingly argued, that based upon this hearsay, he had met his burden of proof in proving that facts in this case merited the exception to the three year statute of limitations.

Since the issue in controversy was the amount of gross income received by the corporation in 1967, and since the

resolution of this controversy turned on proof of laundry expenses, it was therefore, exceedingly prejudicial to the corporation for the Tax Court to admit this tainted information that was so clearly rank hearsay.

The Tax Court reduced the gross receipts claimed by the Commissioner by a straight fifteen per cent, and giving as its reason the facts that 1967 was the first year of operation for the motel, that the elevator was missing and that the building was still under construction, reduced the gross receipts by yet another ten per cent, all for a total 25% reduction in the Commissioner's proof by the comparable method. The overall reduction from the original deficiency determination by the Commissioner was in the amount of \$32,181; this simply means that the Tax

Court found that there was a 52% error between the Commissioner's determination of deficiency as stated in the notice of deficiency and the evidence the Commissioner presented at trial. It is clear from the decision of the Tax Court that the Commissioner failed to meet his burden.

On review, the Commissioner should be barred by the three year statute of limitations from further attempts to assess or collect alleged deficiencies from this taxpayer for the year 1967.

VI

The Tax Court's findings of fraud on the part of the corporate petitioners, Ocean Sands Holding Corporation and Colony Holding Corporation, are illogical and inconsistent with its other findings of

lack of fraud in these consolidated cases.

In the cases of the eight individual taxpayers the Tax Court held, correctly, that the Commissioner had "not carried that burden in proving fraud in the cases of any of the individual petitioners". This holding was based upon "the conduct of the individuals involved and the surrounding circumstances". The case of Stone v. Commissioner , 56 T.C. 213, 223-224 (1971) was referenced by the Tax Court as authoritative in adopting this viewpoint. With this the corporate petitioners agree.

Similarly, in the cases involving Sea Fin Holding Corporation, the Tax Court correctly found that the Commissioner had "failed to carry his burden of proof of 'clear and

convincing' proof with respect to the fraud penalties against Sea Fin".

Therefore, the holdings of the Tax Court that these two corporate petitioners should be singled out held to have committed fraud does not logically follow.

That these findings are illogical is only accentuated by the Tax Court's own observations that it recognized the "inherent imprecision in the method of reconstruction". used by that Court in determining income to the corporations. and that the weakness of the Commissioner's case was underscored by the huge discrepancies between cash dividends asserted for fraud purposes and figures asserted for deficiency purposes.

The Tax Court correctly held that "the burden of establishing fraud, by clear and convincing evidence, is upon the Commissioner. Foster v.

Commissioner , 487 F.2d 902, 903 (6th Cir. 1973), 26 U.S.C. Section 7454(a).

In the case of Loftin and Woodard, Inc. v. United States , 577 F.2d 1206 (5th Cir. 1978), Court warned,

"Fraud is not easily shown. It implies bad faith, intentional wrongdoing, and a sinister motive ... negligence, whether slight or great, is not equivalent to the fraud with intent to evade tax named in the statute. The fraud meant is actual, intentional wrongdoing, and the intent required is the specific purpose to evade a tax believed to be owing ... added to this is the burden placed upon the Commissioner."

The specific intent referred to by the Court was addressed in the case of Kahr v. Commissioner , 414 F.2d 621,

627 (2d Cir. 1969) where it was clearly stated that,

"... the requirements that specific intent be proved before either the civil fraud addition may be assessed or the criminal sanction may be imposed are identical."

Keeping well in mind the holding of the 10th Circuit that,

"The Commissioner has the burden to prove fraud for each year by clear and convincing evidence" Ruidoso Racing Association, Inc. v. Commissioner, 476 F. 2d 502 (10th Cir. 1973).

Based upon the record in the Tax Court it is clear that, as regards the five tax years for which it is asserted that these two corporations understated income, that the Commissioner inflated determinations in the total amount of \$263,250 and averaged over a 51% margin of error. These gross inaccuracies on the part of the Commissioner were part

of a continuing course of conduct against these petitioners. For the taxable years 1967, 1968 and 1969 the Commissioner inflated determinations against Ocean Sands Holding Corporation in a total amount of \$135,025 at an average margin of error of 49%.

The Commissioner "alleged as his basis for fraud that gross receipts were understated and that adequate records were not maintained".

If the findings of the Tax Court are contrasted with its findings as to the errors in deficiencies determined and asserted by the Commissioner the results are extremely instructive. According to the Tax Courts own findings, during the years 1971, 1972 and 1973 Ocean Sands Holding Corporation understated income by an average of 19%; yet during the same

years the Tax Court found the Commissioner's determinations to have been inflated by an average of over 37%. Remembering that the Tax Court's reconstruction of income was based upon an "inherently imprecise method" Ocean Sands Holding Corporation was still almost 20% more correct than the Commissioner on the average. For the years 1972 and 1973 the Tax Court found Colony Holding Corporation to have understated income by an average of 33%; yet during these same years the Commissioner's determinations were found to have been inflated by an average of 72%. Both corporate petitioners, averaged together, were found to have understated income by an average of approximately 26% for the taxable years in question. For the same taxable years the Commissioner was found to have inflated his assertions

of deficiency by an average of more than 54%. Simple arithmetic shows that, based upon the Tax Court's own findings, that the corporate petitioners were more than 100% more accurate than the Commissioner in their reported income for the taxable years in question.

In finding that these two corporate petitioners committed fraud, the Tax Court relied upon its finding of a pattern of substantial understatement of gross receipts as the basic factor for its holding. In the case of Loftin and Woodard, Inc. v. United States , supra, the Court held that "case law does not indicate that consistent and substantial understatement of income is sufficient, by itself, to support a finding of fraud". The Tax Court found the

Commissioner to have consistently made grossly inflated determinations and to have consistently overstated the determinations without substantiation. In the case of Holland v. United States, 348 US 121 (1954), this Court warns,

"Appellate courts should review the cases, bearing constantly in mind the difficulties that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation"

Petitioners contend that the above admonition is especially applicable in these cases.

Inadequacy of Records The Tax Court found as a "badge of fraud" that the "petitioners failed to keep complete books and records and that their bookkeeping system was wholly inadequate". Again, in the case of Loftin and Woodard, Inc. v. United States, we are told that an indicia of

fraud is the "lack of adequate books and records which one would expect of the particular taxpayer, based upon his business experience, education, knowledge of books and records, etc."

The record is replete with evidence that these are corporations operated by family members who do not have the benefit of sophisticated, formal educations. Taxpayers with limited education and training in the keeping and maintaining of business records are not held to the same standard of accountability as those with extensive background and education in the field.

Candela v. United States , 635 F. 2d 1272 (7th Cir. 1980). The record further shows that the petitioners maintained adequate, albeit simple, records and that the difficulty concerning the records results from the fact that numerous records have been

lost, stolen or destroyed by fire over the past 17 years. The Tax Court holds another "badge of fraud" to be the "history of repeated incidents, including a series of fires (two of which are highly suspicious), in which records were allegedly destroyed." The petitioners have consistently explained their inability to produce certain records; the Commissioner has consistently hinted that this is "suspicious". In Carter v. Campbell , 264 F. 2d 930 (5th Cir. 1959), the Court states,

"Fraud implies bad faith, intentional wrongdoing and a sinister motive. It is never imputed or presumed and the courts should not sustain findings of fraud upon circumstances which at most create only suspicion."

Lack of Cooperation The Tax Court found "Petitioners' officers' refusal to cooperate with the revenue agents in

their investigation" to be an additional "badge of fraud". Again, in Loftin and Woodard, Inc. v. United States , supra, the Fifth Circuit reminds us that,

"Where fraud is alleged against a corporate taxpayer, the requisite proof of fraudulent is to be found in the acts of its officers, inasmuch as the corporation, being an artificial person created by law, can have no separate intent of its own apart from those who direct its affairs."

In that same case the Court also advises that,

"In investigating the issue of corporate fraud, the court must determine whether the conduct and intentions of the corporations and/or agents may be imputed to the entity itself."

It is clear from the record that, even after being advised that she and her husband were personally under criminal investigation, Elsie B. Chaplain cooperated fully with revenue

agents investigating the petitioner corporations and that Suzanne Chaplain Goldsticker, who was a corporate officer and is not a party to any of these proceedings, also cooperated fully. The Tax Court prejudices the petitioner corporations when it attributes the alleged non-cooperative attitude of Russell Wilson Chaplain, Sr. to the corporations.

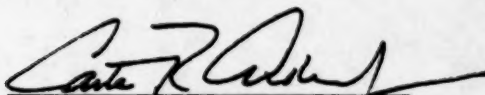
Use of Cash The Tax Court finds, as a further factor in its determination against these petitioners, the "extent to which the petitioners dealt in cash" and "the general custom of each of the corporations of dealing substantially in cash". Again, the Tax Court prejudices the petitioner corporations when it links the emotional aversion of Russell Wilson Chaplain, Sr. to dealing

with banks to the corporations. Russell Wilson Chaplain, Sr. was not an owner, director, officer or employee of these corporations. The personal feelings of Russell Wilson Chaplain, Sr. about banks, or anything else, are not proper evidence, much less proof of fraud, against the corporations. These corporations operate motels. Travelers deal in cash. Merchants and suppliers give discounts for cash payment. The Tax Court's findings as to the use of cash in the business dealings of the petitioner corporations constitute error against them.

CONCLUSION

For the foregoing reasons this
Petition for a Writ of Certiorari
should be granted.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Carter R. Anderson, Jr.", with a long, sweeping horizontal stroke extending to the right.

Carter R. Anderson, Jr.
Counsel for Petitioners

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June 17, 1983

CERTIFICATE OF SERVICE

Pursuant to Rule 28.5(b) of the United States Supreme Court I hereby certify that on the 17th day of June, 1983, by my direction, Susan S. Williams of Lawyers Printing Company, Suite B-115, 7th and Franklin Building, Richmond, Virginia, mailed first class postage prepaid, from Richmond, Virginia, three copies of the foregoing Petition for a Writ of Certiorari to Glenn L. Archer, Jr., Esq., Assistant Attorney General and Michael L. Paup, Esq., Ann B. Durney, Esq., and Stanley S. Shaw, Jr., Esq., Attorneys, Tax Division, Department of Justice, Washington, D.C. 20530.


Carter R. Anderson, Jr.